

I-14.02

Buchanan Air Corporation's board of directors is elected by a vote of the common stockholders. As such, the board believes that it owes a fiduciary duty to maximize the returns for common shareholders. The board is evaluating a proposal to raise an additional \$10,000,000 in capital by issuing preferred stock. The company's underwriter for the preferred stock offering has determined that the preferred stock will carry a 3% rate if the preferred shares are offered as cumulative shares and a 4% rate if noncumulative.

The board plans to pay out annual dividends equal to net income for each of the next four years. The anticipated income is \$300,000 in 20X1, \$0 in 20X2, \$900,000 in 20X3, and \$1,800,000 in 20X4.

Prepare a table showing how much in dividends would be paid to common shareholders if the preferred stock is issued as cumulative versus noncumulative. To maximize the anticipated return to common over the next 4 years, should the board conclude to issue the preferred stock as cumulative or noncumulative? If the anticipated income pattern were different, could a different conclusion be reached?